

Presentation by Roger Guffey, President, Federal Reserve Bank of Kansas City at the Rotary Club Luncheon, El Dorado, Kansas, March 23, 1977.

It ~~certainly~~ is a pleasure to be here in El Dorado today to meet with the Rotary Club. ^{ON A PERSONAL LEVEL} ~~Not only am I~~ pleased to be able to visit with my good friend Phil Hamm here on his home ground, but ^{AM} I'm ^{ALSO} happy to have this opportunity to discuss with you some matters of mutual concern. These occasions are particularly appropriate because I believe that we at the Federal Reserve ^{have} ~~should~~ ^{AN OBLIGATION} always strive to ^{IMPROVE} ~~better~~ our communication with you, not only to convey our ideas on various policy issues, but to seek your opinion and advice on what ^{is happening} ~~we are doing~~, ^{IN OUR ECONOMY IN THIS PART OF THE WORLD.} ~~as well.~~

No matter what your own business or professional pursuits, you know that developments in the national economy have a fairly direct relationship to the business activity right here in El Dorado. In our highly integrated economy, overall economic developments are essentially reflections of occurrences in El Dorado, Wichita, Kansas City—everywhere, ~~really~~ which ~~have~~ come together to form a picture. What you see in that picture, in turn, influences the business and personal decisions many of you make.

Those of you who regularly follow national economic and financial developments and integrate them into your own decisionmaking know quite well the broad sweep of economic events of the 1970's: an energy crisis which involved an embargo and later a quadrupling of the price of imported oil stock, credit crunches, double digit inflation, deep recession, and so forth. It was just two years ago, you will remember, that the nation's economy hit bottom and began to recover from the deepest and most severe recession of the postwar period. Then, following five quarters of rapid growth, the economy experienced the so-called "economic pause" of 1976 during the late summer and fall of last year. Recent data now confirm that following the pause the economy's strength re-emerged and picked up momentum toward yearend, and many observers--including myself--believe that much of the recent increase in business activity is the result of the workings of normal self-corrective forces in the economy.

Most recently, it appeared that the harsh winter weather and related energy shortages experienced in many parts of the nation and which resulted in temporary unemployment and

lost production would have a serious negative effect on the renewed economic recovery. As it looks now, however, those weather and energy troubles of early 1977 apparently will have a lesser impact on the overall economy than had been earlier feared. Of course, those ~~American~~ employers and workers most affected by the winter's excesses did suffer in a most direct way, but the economy as a whole appears to have escaped with only minimal damage. I would expect that most of the short fall of lost wages and production will be made up in the second quarter of this year.

A potentially more serious problem for the nation and its consumers is the worsening drought in much of the western United States. While wheat growers in northwest Kansas and eastern Colorado may be breathing a bit easier as a result of the heavy snowfall received recently, many of the food producing regions ^{of our country} are suffering extended dry conditions which threaten food production and, ultimately, food prices, ^{which would have} ~~with~~ an obvious impact on the entire economy.

It is my assignment today to review the overall economic outlook for 1977 on a national level, and I want to say ~~right~~ at the outset that I believe 1977 will be a good year for business activity, absent some unforeseen outside shocks such as a severe drought--another oil embargo or otherwise. After the brief pause last year, we saw business activity begin to accelerate again late in the year, led by consumer spending and the homebuilding industry. As sales picked up, businesses were able to work off their excess inventories which had accumulated during the pause. And as orders for goods came more rapidly, production speeded up, all which translated into a higher demand for labor. As a result, a record 89 million Americans are now employed--the largest number in our history. With a large and growing number of people employed, personal incomes have continued to rise at a steady pace.

This very positive situation I've outlined may be viewed as a springboard for 1977 and even 1978. Consumers and businessmen appear to be optimistic. Both have money to spend and they are spending it. Furthermore, there is ample credit available at rather modest

rates to finance the purchases of goods and services by consumers, as well as for expansion by businessmen, who are encouraged by growing consumer confidence.

For 1977 and into 1978, most major sectors of the economy appear bullish. Housing is strong because demand is high and mortgage money is available. Business spending for inventories is likely to rise in coming months to rebuild depleted inventory levels--thus reflecting the expected continued strength in consumer spending. Businessmen also are likely to spend at a higher rate for capital projects. Business capital spending has been sluggish throughout in the current recovery, but is expected to be much stronger in upcoming quarters--especially if the sharp increase in orders for capital goods recorded in recent months is an accurate indicator.

Among the demand sectors of the economy, one particularly difficult sector to judge is the foreign exports markets. Most of the major economies of the world have recovered more slowly than has ours from the deep recession, many foreign buyers beset by slow growth and inflation, plus international payments imbalances, are not in a position to buy U. S. products aggressively, nor will they be in such a position in the near future. Further, most of the large food producing nations have reported good crop years and we may expect somewhat less stimulation from export demand for our agricultural products in the coming months.

Overall, it seems clear to me that the economic developments we are witnessing now, and those which we can reasonably foresee, indicate a continued moderate business expansion in 1977 and perhaps well into 1978. Let me add further that the stable financial conditions which have characterized the recovery and expansion so far with an accompanying decrease in the rate of price inflation will continue to be a major object^{ive} of the Federal Reserve monetary policy in the period ahead.

The relative financial stability which we have enjoyed during most of the economic recovery is largely the result of the Federal Reserve's monetary policy. This policy has been

designed to promote conditions which will foster a substantial expansion in economic activity while, at the same time, guarding against any rekindling of inflationary pressures. In implementing this policy, the Federal Reserve has sought moderate rates of growth in the money supply. To illustrate, starting at the trough of the recession in the spring of 1975, the most familiar measure of the money supply (M1) has grown at a rate of about 5.6 per cent. This money growth has, I believe, been adequate to finance the large gain in the volume of output and employment that we have experienced.

At the same time, by holding firm to its moderate course--despite pressures from various sources to boost money growth more rapidly--the Federal Reserve has helped to dampen inflationary expectations of our business and consuming public. In short, by refusing to create more money than appeared reasonably needed to fuel the economic recovery, the Federal Reserve has contributed to a strengthened confidence at home and abroad in the present and future value of the dollar.

In this environment, interest rates have not risen as would have been expected in a normal recovery period and, in fact, almost all market rates are lower now than at the beginning of the expansion period. With money in ample supply and its cost relatively low and stable, prospects for continuation of the expansion are in my judgment enhanced. As noted earlier, credit is available for housing, for consumer expenditures on autos and other goods, and for business spending on inventories and new plant and equipment. Moreover, the stable and less inflationary environment has permitted financial institutions, including banks and savings and loans, business corporations--and even households--to rebuild badly needed liquidity.

Overall, I feel confident that the sound growth evident in most sectors of the economy--combined with the favorable financial environment--augur well for business in 1977. However, beyond 1977, I must temper my optimism because of a concern about some fundamental and

structural problems present in our economy for which answers must be found. My concern is increased by some of the solutions now being considered at the Washington level.

One major problem is unemployment. The existence of a pool of unemployed labor resources in our economy is to be sure an economic problem, but perhaps more important-- It poses a serious social problem. Unfortunately, it seems to me that much of the current public rhetoric concerning unemployment obscures some of the more basic issues.

As a nation, we cannot long tolerate a situation where 7 million persons are unable to find work--as reflected by the latest unemployment data. The rate of unemployment continues to hover around 7.5 per cent overall. On the positive side, we should not lose sight of the fact that the current rate is well below the 9 per cent rate reached in 1975. This improvement in the last year or so is even more impressive when you consider the continued rapid growth in the nation's labor force, which adds new entrants or reentrants into the labor market every week--workers who also must be absorbed into the economy mainstream. Furthermore, a close analysis of the structure of the unemployment figures yields perhaps the most instructive insights into the problem.

For example, as a statistical category, breadwinners who are heads of households experienced an unemployment rate of 4.9 per cent in February--high by historical standards to be sure--but about a point below the 1975 average rate, and well below the 7.5 per cent overall unemployment rate. At the other end of the spectrum, the category of workers 16-19 years old suffered an unemployment rate of 18.5 per cent in February. The rate for minority workers was 13.1 per cent and for part-time workers, the rate was more than 10 per cent. It is apparent that the younger, unskilled workers are bearing the brunt of the current labor market imbalances.

What then should we expect from this kind of structural unemployment? Well, unfortunately, so long as young workers enter the labor force without the skills needed to

compete for and hold productive jobs, and so long as union rules and the minimum wage laws remain unchanged, then we probably should not expect to see rapid reductions in unemployment in the groups made up by the young and minorities. Some authorities quickly recommend government programs to upgrade the skills among these structurally unemployed workers to prepare them for the kinds of jobs available in an increasingly sophisticated and expanding economy. I personally prefer programs which would provide an incentive to private industry to solve this problem.

For experienced full-time workers, the outlook will be much brighter as the economy continues to expand. For these workers, it is to be expected that job opportunities will continue to develop and that unemployment data affecting them will again begin to reflect the more traditional patterns. In any case, structural unemployment is a complex problem which must be addressed and solved outside the arena of emotional and political rhetoric.

The public perception of ~~labor~~ unemployment is one of the major reasons that policymakers are often tempted--and in fact now are planning--to add the stimulus of more Government spending to boost the rate of growth of the economy and hopefully solve these problems. However, because the economy does appear to be on a clear and positive growth path, I hope the Administration and Congress ~~to~~ give serious consideration to the longer range impact of the proposed stimulus programs. I say this primarily because of my concern that we must continue to make progress in reducing the rate of inflation to minimize the harsh penalties that inflation extracts from everyone in the nation, including the unemployed. In my judgment, fiscal policy programs which do not take account of their potential inflationary impacts may do serious longer-range harm to the stable, moderate-growth environment that we seek.

Many Americans now realize the cause-and-effect relationship between the persistent large Federal deficits and inflation over the past 15 years. While there obviously have been many complex and interrelated factors involved in the nation's ~~post~~-inflationary experiences,

I believe that the continuing pattern of large Federal outlays in excess of revenues has contributed significantly to the decline in public confidence about economic stability and--in more direct terms--was one of the root causes of the recent recession and its severity.

Because of diminished public confidence which results from persistent Federal deficits which have been running in the range of 50 to 80 billion per year and their inflationary results, many observers--myself included--are concerned about the size and shape of the fiscal stimulus package now being considered in Washington. This program undoubtedly will include the \$50 rebate as a major feature, although the other parts of the package are still being formulated.

There is considerable concern in Congress about how the Federal Reserve will react when the stimulus package is implemented, that is, will we act to offset some of the impact by restraining the growth rates of the money supply or will ~~we~~ ^{be willing to} tolerate the higher growth rates which will ~~occur~~ ^{surely occur}. Chairman Burns offered some assurances during congressional testimony recently when he said that the rebates will temporarily add to the rates of growth of the money supply in the second and perhaps into the third quarter, but he noted that the fiscal stimulus goals of the Carter Administration--as presently outlined--can likely be accommodated within the Federal Reserve's long-range monetary growth targets. I agree that ~~the~~ ^{the} fiscal actions planned for 1977 can be accommodated by the Federal Reserve and particularly in view of two important facts. Namely--we are now operating at only about 80% of our plant capacity and further that the present Federal expenditures are running about 9 to 10 billion dollars below expectations. However, you should not be surprised to see a more rapid growth of the money supply for some short ~~period~~ ^{time} following the rebate period.

^{optimism about 1977 does not}
My assurances do not, however, lessen my concern about the need for a good balance between the stimulus programs and our efforts in the longer term fight to control inflation. While many of us see little economic justification for additional fiscal stimulus at this time, we also are aware of the realities of the political world. While some of the planned stimulus

programs probably would not be harmful in the short run, the important question is where is that line between moderate stimulation and the kind that will renew strong inflation pressures?

In my view, the timing of the impact of the stimulus is critical, particularly as we look toward 1978. For example, if the economy moves ahead strongly this year as we anticipate and then

is stimulated again in 1978, as planned, via new spending or additional tax cuts to the tune of ~~about~~ 15 to 17 billion dollars--which ~~will~~ result in another large Federal deficit--isn't there

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a danger that pressures could mount on our capital markets?

and renew inflationary expectations.

Yes, that danger is real. Large Federal deficits mean Federal borrowing and lots of it. Those of you who watch financial developments, noted, I'm sure, the rise in interest rates earlier this year which was attributed solely to the fears about the size and shape of President Carter's fiscal package. While it certainly does not appear that the Administration's fiscal plans would cause any serious "crowding out" of private borrowers in financial markets in the near future, it does appear that enlargement of the projected Federal deficit and resulting deficit-induced borrowing of this year and next would, indeed, put pressure on the markets. Such developments will undoubtedly contribute to higher interest rates--if those rates have not already moved upwards as a result of inflationary expectations or from just the normal increase in credit demands from the private sector. Of course, until we get a clearer picture of the ~~final~~ intentions of the Administration and Congress, it is difficult to make any precise judgments about the ultimate economic and financial impacts.

which will tend to

If I have stressed a longer-run perspective about our economic situation today, it is with good reason. I believe economic policymakers have ~~an~~ opportunity in 1977 to build public confidence in the future of our national economic health. If this confidence can be strengthened

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Adopt those policies

now through promotion of moderate--but sound--economic growth and ~~the absence~~ of infla-

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AND IF WE CAN RESIST

~~the temptation to apply~~ a quick fix ~~for~~ fundamental economic problems, then I believe the future

is indeed bright for some years ahead.

Solve the

In conclusion, let me say again that I strongly believe that wider public understanding of economic problems can contribute to an environment in which ~~these~~ ^{These Problems CAN} be solved realistically. Thus, meetings with groups such as the El Dorado Rotary Club provide ^{an} excellent opportunities for improved understanding ~~of these~~. I particularly appreciate this opportunity to ~~discuss these~~ ~~issues with you.~~ ^{have been invited and to participate} in your Rotary luncheon today.

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